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E.O. 12958: N/A
TAGS: ECON EFIN NI
SUBJECT: MOVEMENT OF PUBLIC SECTOR FUNDS, AN OPTION FOR NIGERIAN MONETARY POLICY

¶1. Summary: In its FY 2004-2005 Monetary Guidelines, the Central Bank of Nigeria (CBN) stated its intention to move public sector funds from commercial banks to the CBN as an instrument of monetary policy. The CBN has advised banks to restructure their deposit liabilities to avoid being caught unprepared, and has said it will provide adequate notice before making withdrawals. The proposed policy instrument faces stiff opposition from the banking industry. Bankers insist that public sector deposits are their lifeline, particularly in an economy where personal savings are relatively low, and say that the withdrawal of public sector deposits will cause some banks to collapse. End summary.

The Policy

¶2. Along with other monetary policy measures, the CBN plans to use the movement of public sector deposits into and out of the commercial banking system as a means of controlling liquidity. Funds may be withdrawn from or injected into the system depending on prevailing monetary conditions and CBN objectives. CBN officials say they will notify banks before such movement of public sector funds, but they advise banks to restructure their deposit liabilities to avoid adverse effects of large-scale withdrawals.

¶3. The proposed policy measure faces stiff opposition from the banking industry. Bank executives believe such action will destabilize the system and cause some banks to collapse, primarily because the banking sector relies heavily on public sector funds in an economy where personal savings are relatively low. The CBN's Deputy Governor for Financial Sector Surveillance, Tunde Lemo, had argued while chief of Wema Bank in 2003 that public sector deposits had become a stabilizing force and warned that large-scale withdrawals of funds would adversely affect many commercial banks. Lemo recently made an about-face, arguing that "good banks" should establish more branches and consider mobilizing other deposits, particularly from small savers.

¶4. CBN officials insist they will not forswear use of the proposed measure and have advised banks to invest their public sector deposits in liquid short-term instruments that can be converted to cash quickly and easily whenever the CBN plans to withdraw funds. Ernest Ebi, the CBN,s Deputy Governor for Policy, says President Obasanjo would prefer that public sector deposits be permanently transferred to the CBN; Ebi and other CBN officials recommended, however, that funds be kept in commercial banks. Their core business, he said, is deposit mobilization, and the CBN cannot perform the function better than they can.

But No Result (yet)

¶5. On March 12, the CBN's Monetary Policy Committee (MPC) announced a decision to tighten monetary policy by withdrawing N40 billion ($294 million) from commercial banks to reduce excess liquidity, or inflationary pressure, as the economy is showing signs of modest economic recovery. The MPC's Secretary, James Olekah, rationalized the withdrawal by saying it was partially aimed at lowering interest rates.

¶6. The proposed withdrawal never occurred. Ebi confirmed that the CBN was toying with the idea of withdrawing public sector deposits but said the CBN reversed its March 12 decision after the Nigerian National Petroleum Corporation (NNPC) and other government agencies withdrew significant funds from commercial banks during the week of March 15. Ebi cautioned that the CBN reserved the right to use the policy instrument whenever necessary. CBN spokesman Tony Ede added that the setting aside of N105 billion ($772 million) as collateral for inter-bank clearing of checks by Nigeria's seven settlements banks made large-scale withdrawals of public sector deposits unnecessary at this time.

Comment

¶7. If the CBN's new policy instrument were to cause a handful of relatively weak banks to close, Nigeria's banking system might actually be strengthened. Some Nigerian banks seem to

do little else beyond storing and investing public funds. Keeping the closures orderly and the depositors compensated appropriately will be important. If the measure were to successfully re-orient more viable banks away from reliance on public sector deposits, it might prompt them to better tap underutilized capital from other sectors of the economy for deposits. In that event, Nigeria's largely under-serviced informal sector could become increasingly important to banks' bottom line.
ROBERTS